Union Calendar No. 882

94th Congress, 2d Session - - - - - - - House Report No. 94–1762

PROBLEMS OF SMALL RETAIL PETROLEUM MARKETERS

A REPORT

OF THE

SUBCOMMITTEE ON ENERGY AND ENVIRONMENT

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

together with

ADDITIONAL VIEWS

October 20, 1976.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE

89–006 WASHINGTON : 1976

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LETTERS OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C., October 20, 1976.

Hon. CARL ALBERT,
The Speaker, House of Representatives,
Washington, D.C.

DEAR MR. SPEAKER: Transmitted herewith is a report of the Subcommittee on Energy and Environment entitled "Problems of Small Retail Petroleum Marketers."

This report is submitted with the approval of the full Committee.

With kindest regards, I am

Very sincerely yours,

TOM STEED,
Chairman.

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ENERGY AND ENVIRONMENT,
Washington, D.C., October 20, 1976.

Hon. TOM STEED,
Chairman, Committee on Small Business,
U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a report of the Subcommittee on Energy and Environment entitled "Problems of Small Retail Petroleum Marketers."

The report, transmitted to you as Chairman of the Committee on Small Business, has the approval of the Subcommittee.

With kindest regards and best wishes, I remain

Sincerely yours,

JOHN D. DINGELL,
Chairman.

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PROBLEMS OF SMALL RETAIL PETROLEUM MARKETERS

October 20, 1976.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. Steed of Oklahoma, from the Committee on Small Business, submitted the following

REPORT

TOGETHER WITH

ADDITIONAL VIEWS

PROBLEMS OF SMALL RETAIL PETROLEUM MARKETERS

CHAPTER I.—INTRODUCTION

In a 24-month period between the beginning of 1972 and the end of 1974, the total number of retail gasoline service stations in operation in the United States decreased by more than 30,000 which is equivalent to about 15% of the number of such outlets. While the loss of this many business opportunities within the general economy would be disturbing, a decrease of this magnitude within just one sector of a single industry is disastrous. Even more alarming is the prediction that, if present trends continue, an additional 40,000 service stations will go out of business by 1980. The combined loss of 70,000 retail petroleum marketing outlets within an eight year period will mean that by 1980, one out of every four service stations which existed in 1972 will be permanently closed. This will not only mean that 70,000 businessmen have lost the opportunity to compete in our economic system, but that consumers will be deprived of 70,000 alternative sources of fuel and automotive repair services and of the competitive prices from the continued operation of those alternative sources of supply.

Because the vast majority of retail petroleum marketers are small businessmen and women, the House Small Business Subcommittee on Energy and Environment, under the Chairmanship of Representative John D. Dingell (D–Michigan), initiated an investigation to determine the causes of this dramatic decrease in the number of small business opportunities in this sector of the petroleum industry so that it could thereby formulate recommendations which would help preserve this vital segment of our Nation's economy.

In view of the fact that the decline in the number of retail petroleum marketers has occured in all sectors of the Nation, Chairman Dingell scheduled six days of hearings in various parts of the country so the Subcommittee could obtain a national view of the nature and scope of the problem. This would also allow those small businessmen and women most affected but who frequently lack the time and resources to come to Washington, the opportunity to testify. The Subcommittee met in the Bronx on October 16th, in Poughkeepsie, New York on October 17th, and in Babylon, New York on October 18, 1975, in Chicago, Illinois on February 27, 1976, in Holyoke, Massachusetts on March 5th, and in Fresno, California on April 23, 1976. The Subcommittee received testimony from more than 80 witnesses. These witnesses included representatives from various Federal and State agencies, the major integrated oil companies, oil jobbers, individual service station operators and officials of State petroleum retailer associations which had a combined membership of approximately 20,000 service station dealers.

In addition to Chairman Dingell, the members of the Subcommittee are: Rep. Fernand J. St Germain (D–R.I.), Rep. John J. LaFalce

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(D–N.Y.), Rep John Krebs (D–Calif.), Rep. Martin A. Russo (D–Ill.), Rep. Herman Badillo (D-N.Y.), Rep. Floyd J. Fithian (D–Ind.), Rep. Silvio O. Conte (R–Mass.), Rep. Hamilton Fish, Jr. (R–N.Y.), Rep. William S. Cohen (R–Maine), and Rep. M. Caldwell Butler (R–Va.). The Chairman of the Full Committee, Rep. Tom Steed, is an ex-officio member of the Subcommittee.

Chapter II.—Background

PREFACE

To fully comprehend the problems of the retail petroleum marketer, it is necessary to understand the relationship of retailing to the other segments of the industry. This is important because of the integrated structure of the petroleum industry and because retailing constitutes the final transaction within this system and is therefore affected by occurrences in those preceding sectors. As the hearings which are the main concern of this report were confined to an examination of only the marketing segment, the Subcommittee staff has compiled a description of the operations of and interrelations between the other sectors of this industry from the numerous hearings and reports published by this Committee's predecessor, The House Select Committee on Small Business.

In the course of its 34 years of existence, the Select Committee conducted over 20 investigations into various aspects of the petroleum industry. Generally, those previous efforts were confined to an examination of the particular problems of small businessmen within an individual sector. Thus, the problems of the independent producer were discussed in terms of his position within the production sector. While these past efforts provide the data base for the following description of the industry, their limited scope and at times, their datedness created informational gaps. To correct this problem, the staff has, wherever possible, updated the information or utilized generally recognized although occasionally disputed theories. As this description is provided for informational purposes and relates to matters beyond the scope of this hearing, this background section does not constitute conclusions on the part of subcommittee or the full committee.

Additionally, the imposition of Government controls upon certain parts of this industry, especially upon the price of domestically produced crude oil and upon the wholesale price of gasoline, has resulted in the creation of certain temporary artificial conditions. Because of the expected removal of these controls, it is better to review the operation of the industry in the context of its historical development up to the point of the imposition of these controls. By so doing, the projected behavior of the industry after the elimination of the existing controls can be accurately anticipated.

Furthermore, while it is necessary to consider the problems of the retail petroleum marketer in terms of his relationship to the entire industry, it is important to realize that the position of the small independent gasoline marketer is unique among retailers of other extensively advertised products which are sold under the brand name of a supplier or manufacturer. For this reason, it is appropriate to compare gasoline retailers to marketers of other mass-produced goods. For example, service station dealers are often compared to automotive or appliance dealers because they all sell manufactured items, the production of which necessitates enormous capital investments. Unlike other manufactured goods, gasoline is a nonreuseable consumable item which most consumers replace on weekly basis.

Because of the number of outlets and frequency of use, gasoline retailers are also compared to fast food franchisees. But to millions of Americans, gasoline is an essential commodity, while fast food outlets are merely conveniences. Because of the necessity of their product, service stations are frequently compared to small grocery stores. However the integrated structure of the petroleum industry distinguishes gasoline marketing from the retailing of food. A small grocery store operator can independently obtain his needs from a variety of suppliers, and can even go directly to the producer, which in this case, would be a farmer or rancher, to secure his requirements. This is because the grocery store's supplier does not own the majority of farms or ranches. It does not grow or harvest the crops or breed and slaughter the animals. It does not own the most efficient means of transporting these commodities nor does it own the majority of the processing or canning facilities. Because gasoline in its natural state is commercially useless and because the cost of a refinery is prohibitive for almost all marketers, a service station dealer must secure his needs from a refiner. Because of this fact, and because, as will be shown, the large integrated refiners are so extensively involved in the ownership of all aspects of the petroleum industry, it is necessary to view the problems of the gasoline retailer as unique and therefore deserving of special legal consideration which is distinct from that afforded other retailers.

STRUCTURE OF THE PETROLEUM INDUSTRY

The petroleum industry can be divided into four separate parts which are most commonly identified as "production," "transportation," "refining," and "marketing." If it were not for the extensive participation of the same few firms in all four of these sectors, each would be economically significant enough to be considered a separate industry. However, because of the historical development of this industry and because of the economic forces and precedents which have resulted from the monopolistic practices which characterized formation of this industry, the vertical integration of oil companies has, to date, been considered an acceptable form of corporate organization. As a result, these individual operations involving petroleum have come to be considered as part of a single industry.

The production sector of the petroleum industry is involved in the exploration for and extraction of crude oil from the earth. When the House Select Committee on Small Business was established in the early 1940s, one of its first investigations concerned the problems of the independent oil and gas producers, who were those which were not owned or controlled by an integrated oil company. At that time, the Committee estimated that there were over 20,000 such producers in the United States. Thirty years later the American Petroleum industry estimated that that number of producers had been reduced to only 8,000. In 1944, those 20,000 independent producers accounted for approximately 50% of all domestic crude oil production. By 1960, the independent's share of crude oil production had fallen to 37% and by 1970 the independent producers accounted for only 30% of all domestic crude oil production. The decreasing share of the production sector held by a declining number of independent producers was offset by the growth of the 20 largest integrated oil companies' increasing control over domestic crude oil production, which rose from 50% in 1944 to 63% in 1960 to over 70% in 1970. Consistent with the trend, the four largest producers expanded their share of crude oil production from 26% in 1960 to 31% in 1974; and the eight largest producers increased their share of crude oil production from 43% in 1960 to 49% in 1974. Thus, by 1974 the four largest producers accounted for more domestic crude oil production than the 8,000 independent producers combined, whereas just 30 years ago, the independents produced more domestic crude oil than the 20 largest integrated oil companies combined.

This trend toward increased concentration within the production sector is expected to continue unabated. The grounds for such a projection are numerous. First, according to the 1973 Federal Trade Commission's preliminary staff report on the petroleum industry, the 20 largest producers control 93% of the Nation's proven domestic reserves of crude oil. In fact, the eight largest producers control 64% and the four largest control 37% of our proven domestic reserves. These percentages significantly exceed each group's present share of domestic production.

Second, drilling rights in many exploratory areas of this country are being auctioned off in large blocks and the price of a single block can amount to hundreds of millions of dollars. Assuming an independent producer could obtain the capital to purchase off-shore drilling rights, additional financing would be necessary to pay for the exploratory drilling costs and today, if producible quantities of oil and gas are discovered, the construction of producing platforms and facilities can cost from $45 million to over $200 million each. Since most experts agree that a large portion of this country's future crude oil reserves will be found in hostile environments, such as Alaska or deeper offshore waters, the cost of exploring for and producing oil cannot be realistically expected to decrease. Thus, given the prohibitive costs of purchasing exploratory drilling rights and equipment for such exotic areas and the degree of the major integrated oil companies' control of proven reserves, the independent producers today face the possibility of being excluded from the production sector of the oil industry.

Prior to the imposition of federal controls on the price of crude oil, the legislatures of most of the larger oil producing states had enacted laws which regulated the production of crude oil. These prorationing systems and spacing regulations and unitization practices have eliminated waste, improved efficiency and allowed for the recovery of a greater quantity of crude oil, but as a result of these practices, competition within the production sector has been eliminated.

In its natural state, crude oil is commercially useless and must be processed or refined to form usable fuels, such as gasoline, jet fuel, diesel fuel, home heating oils, etc. Today there are only about 130 refining companies in the United States and a small number of these own a majority of the industry's refining capacity. According to the previously cited 1973 FTC staff study, in 1970 the 20 largest integrated oil companies controlled 87% of this country's refining capacity, while the eight largest controlled 58% and the four largest controlled 34%. The concentration in the refining sector is so great that in 1970 the combined refining capacity of the two largest refiners exceeded the total refining capacity of the 110 smallest refiners. As a result, the bulk of crude oil production is refined by just the eight largest firms.

Because of the cost of a refinery, which is estimated to be about $500 million for a new 250,000 barrel a day refinery, it is necessary that it operate on a relatively continuous basis. This not only enables oil companies to maximize their return on investments, but also increases daily production, which spreads the cost over a greater volume and thereby reduces the per unit cost of production. Historically, American refiners have operated in the range of 85% to 93% utilization of capacity, with the maximum sustainable crude run being about 92% of "reported" refining capacity. Since domestic companies refine about 15 million barrels per day, the only feasible method for efficiently transporting this quantity of crude is through pipelines.

There are over 100 interstate pipeline companies in the United States today, but over 90% of the crude sent through this system is transported through pipelines owned, either individually or through joint ventures, by the major oil companies. The cost of constructing a pipeline is exceedingly expensive and a 20% interest in the trans-Alaskan pipeline system cost $1.5 billion. Historically, the profits from these operations have been, for an oil company, relatively small, amounting to only about 6% of an integrated company's profits. But the value of a pipeline lies not simply in its profits, but, more importantly, in its competitively strategic significance.

Pipelines frequently begin at the oil field itself, and the presence of a gathering line greatly increases the economic value of the field. However, if a major oil company is not a significant producer in that field, it has little incentive to construct a pipeline to the field, and can use the lack of a pipeline connection as a mechanism to pressure the independent producer to sell its well until the integrated company has accumulated a significant enough financial interest to justify an investment of the size needed to construct a pipeline. Lacking the necessary financial interest in the crude production, but perhaps in need of the field's output to meet its own refining requirements, the pipeline company can nonetheless construct a gathering line and require the shippers to either guarantee a minimum through-put or establish some other mechanism, such as a tariff, to insure the recovery of its investment.

Crude is sold at the well head and it is the buyer's responsibility to arrange transportation. The quality of crude oil varies, and such factors as its specific gravity, boiling range, hydrocarbon composition and sulfur content greatly affect the quality and even the end uses of the refined product. Because of these factors and because of the effect impurities can have on the refining process and the end product, crude is shipped through pipelines in "batches." By requiring that crude be transported in certain quantities, the number of instances where the varying grades join one another is reduced, and thus the amount of mixing and contamination between differing grades is decreased. This thereby assures that a specific refiner will be provided with a substantial quantity of homogenous grade of crude, which is important to the refinery's efficiency.

To assemble a batch of homogenous crude, the integrated oil company's crude oil purchasing division, or oil traders as they are called, purchase large quantities of crude from numerous producers through division orders. These division orders establish how the price is to be set and how payment is to be made to the royalty owners. The traditional method is for the oil trader to simply publicly post a price, which is essentially an offer to buy. This, in itself, indicates the dominance of the refining sector over the production sector. Occasionally, however, the division order may set the price at the highest posted price in the field or area or at the price posted by another specifically named company. As the field buying organization or oil trader is usually buying for more than just one refiner, it will purchase more than one grade of crude. It will then combine the production of many wells into large batches of homogeneous crude and arrange for their transportation.

The transportation of crude through a pipeline is an exceedingly complex operation. As explained previously, the efficient operation of a refinery requires a relatively constant flow of crude, and the transporting of as much as 250,000 barrels a day of the same grade of crude to a single refinery involves extensive planning and scheduling. Furthermore, the quality of the grade of crude affects the rate at which it can be refined and the speed at which it can be transported through the pipeline which, in turn, affects the rate and thus the quantity of other oil which can be shipped. Additionally, the efficient operation of the pipeline requires that a certain flow pressure be maintained.

The major integrated oil companies have consistently denied that their extensive ownership of the pipelines which carry the bulk of this Nation's crude oil adversely affects competition by pointing out that pipelines are regulated by the Interstate Commerce Commission. However, it has long been recognized that the ICC's regulation of pipelines has been nominal at best. Indeed, when the Subcommittee on Special Small Business Problems of the House Select Committee on Small Business examined the anticompetitive impact of oil company ownership of petroleum products pipelines, it stated in its 1972 report (H. Rept. 92–1617) that "In general, the Subcommittee finds that the attitude of the Commission, as expressed by Chairman George Stafford, may fairly be characterized as complacent. It is extraordinary that pipeline transportation, which accounts for more than 20 percent of all intercity freight movement in this country, should be so casually regulated."

In defense of their ownership, Mr. W. T. Slick, Jr., Vice President of Exxon USA, in testimony before the Senate Judiciary Subcommittee on Antitrust and Monopoly, asserted that there are seldom any complaints regarding a shipper's inability to transport his crude and that if tenders do exceed capacity, existing regulations require that shipments be allocated in proportion to recent shipments or current tenders of new shippers and historic tenders alike. However, as the Small Business Committee's 1972 report explained, there ". . . is an understandable lack of complaints due to fear of reprisals." Additionally, the FTC, in its 1973 staff study, states "Our investigation disclosed charges leveled against these pipeline owners by non-owners who claim they have been excluded from using the common carrier lines. The inherent technological nature of the pipeline system and the petroleum industry provides the basis for such exclusionary practices."

Because of their ownership of pipelines which carry the bulk of this country's crude and because of the rules regulating the transportation of crude through pipelines, the major integrated oil companies have the means by which they can deny the non-owner access to this most efficient and economical method for shipping crude. Lacking access to this system, small and non-integrated refiners have little to gain by relying on independent oil traders, for any savings realized in purchasing the crude would probably be eliminated through the increased costs of alternative transportation.

The integrated company's ability to deny independent traders access to pipelines also enables these companies to apply additional pressure on the independent producer. As the 1973 FTC staff study explains, "The result of this pipeline system is to place the major firms who own the pipelines in an excellent position to discriminate against the independent producer. The opportunity to require the independent to enter into an agreement to sell his product at the well head in order to obtain regular sale and transportation of crude clearly exists for the majors."

Since the major oil companies' ownership of the pipeline systems effectively discourages small and non-integrated refiners from independently purchasing their own crude needs and instead encourages them to rely on the integrated companies to secure their requirements, their absence in the crude oil buying market prevents them from exerting competitive pressures on the price of crude. Thus the only remaining effective restraint on crude oil prices is the retail price of refined petroleum products which, to a large extent, is the result of the competitive forces which still operate in this section of the petroleum industry.

Competition in the marketing sector of the petroleum industry is not simply the result of the number of retailers but also and, perhaps more importantly, a consequence of the independence of a significant portion of these retailers. Throughout the other segments of the industry, the term "independent" has usually been used to describe someone who is separate from and has no continuing relationship with a major integrated oil company. However, in the marketing sector the term "independent dealer" can and, in most instances, does apply to a retailer who not only has a continuing relationship with a refiner, but who markets gasoline using the refiner's brand name or trademark.

There are approximately 300,000 locations in the United States where a motorist can purchase gasoline. About 100,000 of these sell gasoline as an adjunct to their principal source of business. Within this category are grocery stores, parking garages, and general stores which are usually located in the rural areas of the country. This segment of the marketing sector sells approximately 20 percent of all the gasoline sold at the retail level. Although these operators have secured their locations on their own and do not rent them from a refiner, about 90 percent sell gasoline using the brand name of their supplying refiner. However, these outlets, which are called "open outlets" by the Federal Energy Administration, derive, by definition, less than half of their income from the sale of gasoline and provide it mainly as a convenience to the customers of their principal source of business. As they are frequently located in rural areas, they are usually less affected by the intense competitive pressures which are exerted upon urban petroleum retailers who are dependent upon gasoline sales for their economic survival.

According to the Federal Energy Administration's most recent monthly report on petroleum market shares, there were, as of January 1976, 186,000 service stations operating in the United States. As service stations, by FEA's definition, derive more than half of their income from the sale of gasoline, these outlets are dependent on gasoline sales for the bulk of their income and are, therefore, sensitive to the competitive influences of the marketplace. An individual station's degree of sensitivity to price competition is somewhat related to the type of station it is.

Over 90% of all retail petroleum outlets in this country market gasoline by displaying a brand name of the supplying refiner. As in other industries, refiners emphasize brand names through extensive advertising campaigns in order to assure the consumer that the products and services provided at every location displaying that brand comply with certain minimum standards, and that the refiner will remedy any consumer complaints. By so doing, the refiner hopes to develop customer loyalty to his particular brand and thereby retain this individual's business as he or she travels about the city or country. Most refiners are so protective of the image they believe they have developed in regard to their brand that they have created secondary brands in order to market gasoline at outlets which provide a cut-rate price or offer self-service. For example, Exxon uses the name Alert, and Phillips uses as many as 40 different names. While it is debatable whether a consumer first develops an allegiance to a particular brand or to a particular retailer and then seeks out other retailers displaying the same brand, it does appear that there is some consumer reliance on brand names. As a result of this allegiance, which may be partly lethargy, consumers are normally unwilling to alter the customary buying patterns in order to obtain minimal savings. Consequently, branded service stations have traditionally been somewhat immune to price competition from non-branded outlets which amounts to only one or two cents a gallon.

Additionally, branded service stations have traditionally offered the consumer a full line of service, which included checking the oil, battery, radiator, tire pressure and offering engine repair service. Most non-branded dealers had reduced their cost by eliminating these services and concentrating on gasoline sales alone. Non-branded outlets have also pioneered in the development of self-service. Full service branded dealers have survived the competition from the non-branded retailers because they appeal to the kind of customer who is willing to pay more to have the attendant provide the service and who wants to rely on a brand name for product quality assurance. Thus, when refiners began to compete with branded dealers by opening high volume, low overhead company operated outlets managed by a company employee and displaying the refiner's brand name, they injected a new element in the competitive system. These refiner outlets could provide the customer of the quality assurance which comes from using a brand name and at a lower price than offered at a dealer station. By combining many of the benefits that had historically been available at separate outlets, these refiner operated stations undermined the branded dealers' traditional market advantage. While some of the large integrated refiners, such as Exxon and Standard of Ohio, have historically operated such stations, the recent market increase obtained by refiner managed outlets has resulted from the expansion in the number of these operations by such integrated refiners as Gulf, B.P.

and particularly such large refiners as Marathon, Atlantic Richfield, Cities Services, Hess, Ashland, Getty, etc.

The forward integration of these refiners into the marketing sector represents a significant shift in the petroleum industry. Historically integrated companies realized most of their profits from the production sector. With the end of the depletion allowance and certain foreign investment tax credits and the loss of, or at least reduction in, many foreign production concession agreements, refiners have increasingly been forced to seek new areas of profit. As supply approached demand in the marketing sector, retailing became a potentially profitable activity and many refiners, especially those who lack extensive crude holdings, have been quick to expand their marketing operations and establish their market position by offering branded gasoline at a price below that offered by the branded dealers.

Most people in the petroleum industry, and integrated refiners in particular, have historically looked upon price competition with great displeasure. This is because the demand for gasoline is inelastic, which means that, at any given time, motorists need a set amount of gasoline and will pay the prevailing price to obtain it. Consequently, refiners have avoided price competition and instead relied on other forms of competition to attract new customers. Advertising has been the most obvious form of competition, and this method has occasionally been supplemented by special offers of such items as steak knives or dishware and, occasionally, by sweepstakes contests or games. However, the use of games has virtually been discarded as a result of a 1968 investigation of these contests by the House Select Committee on Small Business, which disclosed that many of the major oil companies had coerced dealers into participating in these contests and placed winners at favored stations, and had deceived the public by awarding few or smaller prizes than the amount advertised.

The major integrated oil companies have also traditionally viewed other integrated oil companies as their competitors, and have tried to ignore the nonbranded marketers and even the smaller refiners. As the Vice President of Marketing for Exxon Company USA, Mr. DuVal Dickey, explained in his November 13, 1975, testimony to the House Small Business Subcommittee on SBA and SBIC Legislation, "... We do not consider private brands, like Hess, like Save-way, as the competition we look at in the marketplace. We will take it into consideration, but we will look at the Texacos, the Shells, the Gulfs and the Exxon." This is because these integrated companies have a strong economic incentive to maintain retail price stability.

The major integrated oil companies realize that as long as there is price stability in the retail sector, consumers have been conditioned enough by advertising to maintain their loyalty to their traditional outlets and will ignore the minor savings achieved by patronizing lesser known or private brand competitors. However, they fear that this loyalty is not strong enough to survive price competition from major brands and, in order to maintain this loyalty, a price reduction by one large refiner would have to be met by the others. This would then enable their own branded outlets to maintain their volume of sales. Because of their integrated structure, any decline in the volume of their dealers' sales would have serious consequences in the other sectors of the industry, which could jeopardize its entire profit structure.

The immediate result of a decline in branded sales of one refiner's product would be the creation of a greater surplus of gasoline, which would affect the operation of the refinery. If an integrated company were to significantly reduce refinery operations, its crude oil operations would be affected. Since crude production historically has been an integrated oil company's principal source of profits, a decreased demand could necessitate decreased production or even lower crude prices. Furthermore, a prolonged retail gasoline price reduction would create pressure from the smaller refiners for a crude oil price reduction which would be the only way they could afford to continue to maintain low retail prices. If the integrated companies did not respond, these non-integrated refiners may attempt to independently obtain their crude, which would seriously disrupt these large companies' economic structures. Moreover, these smaller companies may utilize some of the savings realized from purchasing crude at a lower price than offered by the major's crude purchasing division to pay the higher price of alternative transportation. Consequently, the large integrated oil companies have a common economic interest in maintaining retail price stability.

Historically, most of the large oil companies have not been significantly involved in the direct retail marketing of gasoline. Because of their integrated structure and the fact that they have traditionally realized most of their profits from production of crude oil, the large integrated refiners had already realized the profits they made on gasoline before it reached the marketing sector. Indeed, to an integrated company, the retail distribution system had primarily been a means for disposing of a product which had already provided the company with all the profits which would be realized from it. However, in order to insure the stability of the integrated structure, these companies must maintain control over the retail price to avoid any market pressures which, as previously explained, could disrupt the existing structure.

To maintain their control over the retail price of gasoline, and thereby insure their profits through the other and more profitable sectors of the industry, the integrated oil companies established a distribution system that was built upon the brand name of a refiner. Although there are categories of gasoline, such as regular, premium and unleaded, all gasoline within those categories and having the same octane rating is functionally the same, regardless of the refiner. Indeed, refiners not only exchange gasoline among themselves but also frequently pay a competitor to refine some of their crude. As a result, gasoline which for example, is sold as Gulf through a Gulf dealer may have actually been refined by Exxon.

Because of this similarity, many refiners have developed additives which, as their name implies, are added to gasoline. While the actual effectiveness of these additives is questionable, their existence provides the refiner's advertising agency with a means for asserting the superiority of one gasoline over another. In fact, the similarity of gasoline frequently causes advertisers to emphasize not product characteristics, but instead other factors such as the "bell-ringer service," "man who wears the star," "the tiger in your tank," or more recently, the unending and expensive efforts of these companies to find new sources of oil to meet this country's needs and the alleged consumer benefits resulting from the integrated structure of the petroleum industry.

However it is done, the major oil companies spend vast sums of money promoting their own brand name gasoline, and consumers respond by purchasing almost 90% of gasoline from branded outlets.

Another reason why consumers have traditionally purchased most of their gasoline from branded dealers is because there are so many of them. In fact, over 90% of service stations display the brand of a refiner. Since to an integrated oil company the marketing sector was the mechanism by which it disposed of a product upon which it had already realized a profit, these large companies invested great sums of money to insure that there would be enough outlets to distribute the quantities of gasoline they produced. In fact, they actually constructed too many service stations which had the effect of making many marginally profitable and even unprofitable. However, since retailing profits were not important, the efficiency of the retailing system was not a significant consideration. Indeed, there is some evidence that some of the integrated oil companies have historically lost money on their marketing operations, but their integrated structure makes this difficult to determine.

In order to avoid or minimize the losses which have historically been associated with the direct marketing of gasoline, most refiners relied on independent businessmen to sell their product. There are various categories of branded service station operators. The largest single category is the branded lessee dealer. According to the FEA, there were 87,600 such dealers in operation at the end of 1974. A branded lessee dealer is one who leases the station he operates from the refiner whose brand of gasoline he sells. Thus, the refiner is not only his supplier but also his landlord. Since most branded dealers are given only one year leases, the dual role of the refiner enables it to exert significant pressure over the dealer's business decisions, especially in regard to the retail price of gasoline.

The second largest category of branded stations are operated by what FEA calls "open dealers" who sell gasoline under the brand name of the refiner which supplies them, but who either own their own stations or, in a small number of cases, lease them but from someone other than the supplying refiner. As of the end of 1974, the FEA reported that there were 54,000 open dealers.

The third category of branded marketers is the oil jobber, who is essentially a wholesaler who purchases his gasoline from a single refiner and then resells it. Most jobbers are also retailers, and while they do sell to some branded and open dealers, they distribute a large amount of it through stations which they own and which are operated primarily by an employee working on a salaried or commission basis. The FEA reported that at the end of 1974, there were 9,400 stations operated by jobbers.

Regardless of the category to which he belongs, a branded dealer is locked into a single supply source for the term of his contract. In most cases, the dealer must pay a fee to become identified with a refiner and, in the course of the contract, he usually purchases most of his supplies, including his tires, batteries and accessories, from that refiner. Furthermore, his customers develop some loyalty to the brand he displays. Given these facts, even an open dealer becomes tied to his supplying refiner and switching may not be financially profitable for many. Thus, although a branded dealer only has a supply contract with a refiner, that refiner can exert considerable pressure on the dealer. Because of this and because of the fact that the refiner unilaterally determines the wholesale price, which is called the dealer tankwagon price, the refiner can manipulate the retail price of gasoline. If a dealer does not follow the refiner's suggested retail price, the refiner can simply fail to renew the contract.

The large integrated oil companies' control over the branded dealers left the independent non-branded marketer as the only price disruptive actor in the retail sector of the petroleum industry. When there was a surplus of gasoline, the non-branded retailer performed an important function, even for the refiners. But now, for a variety of reasons, there no longer is any significant surplus. And so, because of his continuing ability to market gasoline more cheaply than branded dealers, which is primarily due to his more efficient marketing techniques and his low margin, the large refiners have taken certain actions which will at least mitigate the influence of the non-branded retailer and probably eliminate him altogether.

Certainly, the most concerted and probably the most serious action taken by the large integrated oil companies has been their refusal to sell gasoline to non-branded marketers. This practice has been directed primarily at the larger, non-branded chain operators who sell almost one-third of all the non-branded gasoline sold in this country. These retailers were able to obtain less than 2 percent of their supply from the 8 largest oil companies who refine over half of all gasoline. These large companies now sell their surplus to the smaller and non-integrated refiners who, in turn, sell to the independents. Thus, while the non-branded chain operator can still obtain a supply, he does so at a higher cost because he must now pay a commission to the smaller refiner. Additionally, although these integrated companies do exchange gasoline among themselves, independent marketers allege the large refiners have consistently refused to exchange product with the independent marketers, which increases the transportation costs.

Additionally, as previously explained many refiners, and especially the large independent ones, have begun to aggressively compete with the nonbranded marketer by imitating his marketing techniques. By concentrating on high volume outlets which emphasize gasoline sales and which are managed by company employees, these refiners have eliminated the small independent dealer. Furthermore, by closing their low volume and marginally profitable stations, refiners have substantially reduced the total number of gasoline outlets in this country, which thereby increases the volume at the remaining stations. Some of these refiners have capitalized on the consumer's awareness that branded stations have higher prices by creating secondary brand names which give the impression that they are not associated with a refiner. As these companies have traditionally been the major suppliers of the non-branded marketers, their growing involvement in the direct retailing of gasoline through secondary brand and through company operated branded stations will result in the diversion of increasing quantities of the refiner's product to these operations. Thus, the forward integration of the large refiners not only provides the non-branded marketer with increased competition, but, more importantly, raises the possibility that the independent retailer will soon no longer be able to obtain gasoline from his traditional supplier.

The success of the independent and non-integrated refiners marketing strategy can be seen in the fact that their company operated stations have almost tripled their market share, rising from 3.7 percent in 1972 to 9.7 percent by March of 1976. During this same period of time, stations operated by large integrated refiners increased their market share from 4.5 percent to 7.8 percent. Overall, the market share of refiner operated stations has risen from 8 percent in 1972 to 17.2 percent in March of 1976. Moreover, the total number of company operated stations has increased from 12,480 in January of 1972 to 15,500 in March of 1976, with the independent and non-integrated refiners accounting for 1,200 additional refiner operated stations.

The success of the company owned and operated stations has resulted in serious disruptions throughout the other segments of the retail marketing sector of the petroleum industry. The most seriously affected have been the branded lessee dealers, who experienced a 19-percent decline in the number of stations, going from 142,000 in the first quarter of 1972 to 115,000 in the third quarter of 1974.

The total number of open dealers also declined during this same period, from 64,000 in 1972 to 54,000 in 1974, and their market share fell from 20 percent in 1974 to 16 percent by the end of 1975. The market share of the branded stations directly operated by jobbers decreased from 6.2 percent in 1974 to 4.5 percent by the end of 1975.

Meanwhile, the market share of the non-branded independent retail marketer increased from 7.4 percent in October of 1974 to 10.6 percent in October of 1975. However, in this instance, the statistics are somewhat misleading in that at the time the FEA survey began in 1974, independent retailers were still experiencing marketing problems resulting from their inability to obtain gasoline during the Arab oil embargo, which forced many non-branded dealers to close a large number of their outlets. Thus, while the statistics show that they increased their market share by 3.2 percent, in actuality they merely regained their previous market share which most people in the oil industry concede was about 10 percent. The failure of the FEA to accumulate these figures is inconsistent with the mandate of the legislation which directed the agency to maintain each segment's market position.

One of the principal causes for the growth of certain marketers has been their ability to sell large quantities of gasoline at low prices. In 1974, the refiner operated stations sold an average of 61,000 gallons per month, and the non-branded stations sold 55,500 gallons per month, while the branded lessee dealer sold 24,600 gallons per month, and the open dealer sold 21,300 gallons per month, and the jobber operated station sold 32,800 gallons per month. In February of 1976, the weighted average price over all grades of gasoline and types of service stations for outlets directly operated by major oil companies was 53.8 cents per gallon, while the price at branded dealer stations was 58.5 cents per gallon; and the non-branded retailers price was 53.5 cents per gallon, while the price at the independent and nonintegrated refiner operated stations was 54.5 cents per gallon.

The fact that integrated oil companies are selling gasoline through company owned and operated stations for an average of 5 cents a gallon less than their own branded lessee dealers has serious implications for the small business retailer. The branded dealers' market share has already fallen by 8% and they traditionally have not maintained their volume in a market that offers such price differences. This is particularly true in those instances where the refiner's company operated station sells gasoline under its own brand name as does Exxon, Marathon, Hess, ARCO and others and thus directly competes on a brand name basis with its own branded dealers.

By concentrating on self-service and low retail gasoline prices, these refiners can undercut their own branded dealers. While many branded dealers believe they can survive the competition from the independent marketers and even from the secondary branded outlets, they strongly assert that they cannot endure price competition from their suppliers who market gasoline using the same brand name nor can they long endure the coercive economic pressures which can be exerted against them by a refiner upon whom they are dependent for their supply.

While the refiners' marketing practices are jeopardizing the economic survival of branded dealers, the large integrated oil companies' continuing refusals to directly supply independent non-branded marketers is endangering their continued existence. Already the refiner owned and operated service stations have substantially reduced the difference in the retail price to an average of one cent a gallon. As supply problems continue, these marketers become increasingly dependent upon foreign suppliers who refine the higher priced foreign crude; and as the price of his product increases, so then must the retail price of gasoline, which will eventually eliminate his ability to compete. No longer able to serve his function, the independent nonbranded retail marketer cannot long survive.

In order to protect their independent marketers, some European governments have adopted regulations which impose limitations on the number of stations a refiner can own and which separate the refiner from retailing. The United States has yet to adopt any policy which would effectively protect a small business dealer or independent marketer from the coercive economic power of refiners. As a result, refiner owned and operated stations are increasing their share of the market, and the individual dealers are being forced out of business. While this in some instances may be temporarily providing the American consumer with lower priced gasoline, the ultimate effect will be the destruction of the independent segment of the retail sector of the petroleum industry. Since the independent marketer has historically supplied the price competition in the retail sector and since integrated companies have traditionally avoided price competition, the existing restraints on retail prices will be gone forever.

Chapter III.—Hearings

Although the Subcommittee on Energy and Environment held hearings in various parts of the country, the complaints of the individual retailers were almost universally the same. In essence, the small independent retail gasoline marketers were concerned about the policies of their supplying refiners which were impeding their capacity to effectively compete and endangering their ability to economically survive.

Most of the testimony received by the Subcommittee concerned the problems of the branded lessee dealers, who constitute the largest single category of dealers, accounting for 64% of all branded stations and over 57% of all service stations in the country. As of November 1974, there were 115,000 branded lessee dealers, which is 27,000 fewer than existed in the beginning of 1972. According to the FEA, 81,000 of these are directly supplied by an integrated refiner, 2,362 are directly supplied by a large refiner, and 5,248 are supplied by small refiners, for a total of 88,000. An additional 27,000 branded lessee dealers are supplied by wholesale distributors who are called oil jobbers.

The distinguishing characteristic of a branded lessee dealer is that he not only markets gasoline under the brand name of his supplying refiner but also leases the station he operated from the same refiner. This dual supplier-landlord relationship is somewhat unique among franchise agreements, and gives the refiner almost total economic control over the individual dealer. To further insure this control, most dealers are given only a one-year lease. Lacking the security of a long-term lease, the branded lessee dealer lacks the means to effectively reject the suggestions of his supplying refiner without jeopardizing his business. As stated by Mr. Mac Victor, the Executive Director of the New York State Association of Service Stations, Inc.:

> Because the oil companies are allowed to exercise this dual position, they can and do bring undue pressure on dealers through overt threats, intimidation, and coercion. These forms of harassment work successfully upon the dealer because the oil company controls the life of the lease, its termination or non-renewal.
>
> Using, then, the threat of lease cancellation or non-renewal as their most potent weapon, the oil companies pressure the dealer to capitulation on a variety of business decisions which the dealer, as an independent businessman, should be free to determine for himself.

The branded lessee dealers recited a litany of complaints about certain provisions which are included in most leases. One provision which the dealers found to be particularly obnoxious related to the fact that the refiners determined the hours during which an individual station was to be open. Many dealers felt that some of the hours were unreasonable in that they required the dealer to remain open during times when it would be unprofitable to do so, especially late at night when the costs of hiring additional attendants, paying for increased utility bills and large insurance premiums would exceed the profits realized from the low volume of business available after dark.

As explained by Mr. Bob Jacobs, the Executive Director of the Illinois and Indiana Gasoline Dealers Association:

> You get some areas where you open up at six in the morning and Mister, after seven at night, you can sit there and knit, because the public, they're home. These suburban areas are watching the boob tube. They're home with their families, and yet these oil companies say, "You stay open from 6 a.m. till midnight."

Since the refiner does not bear those expenses, but does realize a profit from the increased volume of gasoline sales which, while at an individual station may be small but when added to others is appreciable, the refiner has used its superior bargaining power to include such provisions in the lease.

Dealers also complained about recent changes in most companies' leases which transferred the responsibility for maintenance from the refiner to the dealer. The purpose of this transfer was to circumvent FEA's rent control limitations by reducing some of the refiners' financial liabilities without monetarily increasing the price. As a result, dealers now must pay for a variety of services which were once provided without costs. This would include the upkeep, repair and replacement costs for gasoline pumps, heating systems, machinery, paint and a variety of other items. What dealers find especially objectionable is the fact that many of the items they must now pay to repair are the property of the refiner. Mr. Phillip M. Hudson, President of the Central California Service Station Association, raised an additional consideration regarding maintenance costs when he explained that:

> * * * before the embargo, most dealers would be able to pick up the phone and say, "I have got a light out" or "I have got a hose broken." But this day and age, they say "You replace your own hose, you replace your own lights." Now they give you a bucket of paint and a paint brush and they tell you "Do your own painting." Those are things that may actually seem trivial to you, but it's a burden on the dealer's time in pumping gas or tuning a car, and he has to utilize every bit of time that he has. So this is another added cost to the dealer.

The refiners argue that the terms of the lease are negotiable, and by signing the lease dealers freely choose to abide by its provisions. This argument understates the case in that, by refusing to sign the lease, the dealer must then give up his business. Some dealers stated that they had consulted attorneys about objectionable provisions. Mr. William Grillo, a New York Gulf dealer, related a typical response. In Mr. Grillo's words, "The lawyer said, 'Bill, you want the station, you have got to sign it, whether you like it or not.' " A Long Island Exxon dealer, Mr. Russel Murway, was also told by his lawyer that he had no alternative. Mr. Murway further stated that Exxon would not provide him with a copy of the lease until after he had signed it and that if he wanted a lawyer to look at it he would have to make arrangements with the sales representative and the district manager.

The dual landlord-supplier relationship also provides the refiner's sales representative with an effective means for coercing dealers into purchasing other products. Under the law, a refiner cannot condition the sale of gasoline on the dealer's agreement to purchase additional products such as tires, batteries and automotive accessories, which are commonly known as TBA's. While the courts have forbidden coercive TBA practices, the fact that dealers have short-term leases, which are normally only one year in length, causes them to constantly contend with the possibility of not being renewed, and they are thus vulnerable to questionable suggestions from their landlord, and many of the refiners' sales representatives are ready to emphasize the tenuousness of the dealer's position.

The Executive Director of the Bay State Gasoline Association, Mr. Maurice Langelier, explained the practicalities of the situation by saying:

> Well, legally, the dealer can go to outside sources, but it's not practical for him to do so, because he's going to get hit, probably, right over the head immediately if he does. The sales rep comes into the station and says, "Well, look, I've got a quota to make, and you've got a quota on this station to make. And, look, if you don't buy from us, you know, many things can happen." In other words, when your lease comes up again, you might have a little bit of a problem getting a lease.
>
> Or there are a few favors to be given out by the company: "If your place needs maintenance, needs repairs, we might not be able to do it, or your deliveries could be a little bit late—24 to 48 hours late."
>
> So it's not practical for a dealer to buy outside. In other words the Sword of Damocles is over his head at all times.

Mr. Tom Anderson of the Pennsylvania Gasoline Retailers Association related his experience when he explained to the company why he was not purchasing their TBA's:

> And I said, well, you know, your price is too high. If you come down, I would be glad to buy them off you; but right now I am buying the same identical tire, which happened to be Goodyear at the time, and I said I am paying $5 less for it, so why should I buy from you. They said, well, I will give you the best reason in the world—you want your lease renewed. You think about it!

Mr. Bob Jacobs, the Executive Director of the Illinois and Indiana Gasoline Dealers Association, asserted that the prices of a refiner's TBA's were not competitive:

> There isn't a product that Standard Oil or Shell Oil or Arco or any of the oil companies sells to which TBA stands up, not one product, not one tire, not one piece of equipment, not anything that any dealer in America with 2 cents' worth of brain can't go out and buy cheaper someplace else, and the coercion is there.

When Robert Nyland, a Worcester, Massachusetts, Getty Dealer, was having lease problems, he told the Subcommittee that the refiner's salesman came in and said "Well, gee, it might help, you know, if you ordered a big load of tires, get some oil in, you know—a big order. They might think you're selling a lot of TBA, and they might reconsider, you know."

In Long Island, the Territory Manager for the New York District of Shell Oil, Mr. Charles A. Baldwin, testified about some of the pressures salesmen place on dealers. When asked by Representative Downey if he had ever seen or engaged in any coercive sales tactics, Mr. Baldwin replied, "I have seen them. I have been subjected to subtle and blatant coercion by my district management to perform these practices." Mr. Baldwin also related the comments of a Shell sales manager during a June 6, 1975, meeting. In speaking about the purchase of TBA and product, Mr. Baldwin stated that the sales manager said, "We want to load them up in the summer. We want our product on the roofs, under the lifts, and in the bathrooms."

Mr. Baldwin further supplied the Subcommittee with Shell Oil Company's New York District 1975 sales objectives, which called for 210 stations to sell 25,974 tires, 14,902 batteries, 156,743 filters, and $113,700 in specialties and $254,300 in accessories.

The fact that the salesmen's discussions are not idle threats can be seen from the testimony of a New York City Mobil dealer. Mr. Paul Rubenfeld told the Subcommittee that in 1954, he responded to a newspaper advertisement soliciting people to become independent businessmen. After being accepted by Mobil, he participated in the company's training program and was given a station in 1955. For 17 years he operated that station, and in 1970 the company presented him with a new car for outstanding sales, and he was the only recipient of this award on the Eastern Seaboard.

The very next year, Mr. Rubenfeld decided that he was not obtaining the best price or even the best quality merchandise on the TBA's he was purchasing from Mobil. Consequently, he began to obtain his requirements from independent suppliers. Up until this time, Mr. Rubenfeld had followed his company's suggestions on prices for both their gasoline and their TBA items, for, as he explained, "When a person like myself deals with a major oil company, it is a known fact that when they give me a 'suggestion,' and that is in quotes, it is not a suggestion. This is an out-and-out order."

After he ceased purchasing his TBA's from Mobil, Mr. Rubenfeld was contacted by a company representative who explained to him that the company had been very nice to him by obtaining this station for him and that the company had spent a lot of money to develop it and people came there because they liked Mobil products. Mr. Rubenfeld said that ". . . he explained to me that I was not appreciative of what they had done for me and that my lease was up on September 30 and that I would not be renewed unless I conformed to the standard industry practice that had been going on." Mr. Rubenfeld rejected this threat and, on Sunday, October 1, 1972, the day after his lease expired, the metropolitan area manager came to his station and requested that he turn over the keys to his station because he was no longer in business. After he refused, he received an eviction notice which he went to court to fight. Although the lower court asserted the company must show "good cause" to terminate the contract, Mobil Oil Company exerted its right to appeal until eventually a court upheld Mobil's action. At the time of the hearing, the court had not ruled on Mr. Rubenfeld's appeal.

The case of Paul Rubenfeld not only shows that the oil companies do use their landlord-supplier relationship to coerce dealers into complying with questionable and perhaps illegal company policies, but that, more importantly, dealers have no means by which they can protect themselves from the arbitrary actions of their supplying refiner. The fact that a refiner can simply fail to renew a branded dealer's lease at the expiration of its term without having to provide any explanation whatsoever was of major and immediate concern to most of the branded lessee dealers who testified.

To avoid the growing problems resulting from the ability of the oil companies to arbitrarily terminate their retailers, the branded lessee dealers advocated the enactment of National Dealer Day in Court Legislation, which would require the oil companies to establish a case for terminating a dealer. By limiting the actions of refiners to certain established grounds, the individual dealers would be free to reject the coercive practices of their suppliers and become truly independent businessmen with the right to purchase their supplies from whomever they wish and individually determine the retail price of gasoline.

While a Dealer Day in Court bill is necessary to establish the independence of dealers, additional action must be taken to protect them from new pressures which are being exerted by their refiner's increased interest in the direct retail marketing of gasoline. As Mr. William Griffin, the Executive Director of the Long Island Gasoline Retailers Association, explained:

> Since we have fought for and obtained, through the New York State Legislature, our dealers day in court bill to protect New York dealers from arbitrary cancellation, the major oil companies have taken a different tactic. They control the retail market through economic pressure, using company owned and operated outlets as their means of control. They are forcing their own franchise dealers into economic ruin by depressing the price.

Mr. Griffin went on to state that "once a market is sufficiently in the control of a few majors, the retail price will be dictated to the public in just the manner the wholesale price has been dictated to captive dealers by the major companies over the years."

Company owned and operated stations pose a dual threat to branded dealers. First of all, a dealer that has a good location with a high volume of business may be terminated so his supplier can convert this station to a company operated outlet. The dealer who has worked hard for years to establish a successful business may be the most vulnerable. Ironically, the dealer's success is what makes the station attractive to the supplier. Without some form of dealer day in court legislation, dealers have no defense against this type of action.

Many witnesses complained that stations directly operated by refiners are posting retail prices for gasoline which are substantially below the retail price posted by competing branded dealers. The Federal Energy Administration's monthly Petroleum Market Shares Report provides statistical evidence that such assertions are valid.

The March 1976 weighted average price over all grades of gasoline and types of service stations was lower for refiner operated stations than for stations operated by branded dealers, with the greatest disparity existing between the average retail price of integrated oil company operated stations, which was 54 cents a gallon, and their own dealers, which was 58.3 cents a gallon. Since the 20 largest refiners accounted for over 83.2% of all gasoline sales in 1974, with the eight largest having 54% and the four largest having 30.9%, this disparity in the retail price of gasoline affected most service stations. This price difference is unquestionably a significant factor in the startling increase in retail sales through company operated stations, which, according to the FEA, grew from only 8% of all retail gasoline sales in 1972 to 17.5% by March of 1976.

Some branded dealers asserted that the retail price at certain stations was almost the same as the wholesale price they paid. Mr. Frank Jones, a Chicago area Texaco dealer, and a Danny Boy station eight blocks away both sell gasoline refined by Texaco. Mr. Jones' dealer tankwagon price was 49.1 cents per gallon, while the Danny Boy station posted a retail price of 51.9. In New York, Mrs. Eileen Grillo and a competing station both sell gasoline supplied by Gulf Oil, and the competing station posted a retail price of 55.9, which she said was below her dealer tankwagon price.

The dealer tankwagon price is merely the wholesale price of delivered gasoline. The dealer must add to this price his costs of operation. The Treasurer of the New York State Service Station Dealers Association, Mr. William Keller, explained that, as a rule of thumb, the average rent used to amount to about 2 cents a gallon and the dealer's payroll costs added another 2 cents, while the cost of electricity, heat, insurance, accounting fees and other miscellaneous ex-expenses came to an additional cent a gallon. Thus, a dealer must add at least 5 cents a gallon to the tankwagon price to make a profit. Mr. Keller emphasized that these were base estimates, and would frequently be higher for many dealers, especially in light of recent rent increases. Consequently, branded dealers cannot compete with stations selling gas at retail prices which approach their tankwagon price.

To a great extent, the difference in the retail prices of gasoline reflects a difference in the wholesale prices. Jobbers pay a lower wholesale price because they purchase their gasoline at the refinery or bulk plant and deliver it to their stations themselves. This is known as the rack price and is usually substantially below the dealer tankwagon price. Mr. James Campbell, the Executive Director of the California Service Station Association, submitted lists of the dealer tankwagon price and the rack price of gasoline in the Los Angeles Basin for March 31, 1976. It showed that the rack price for Gulf premium gasoline was 42.95 cents a gallon, while the tankwagon price was 50.20 cents a gallon, and the prices for unleaded were 42.25 and 47.70, and the prices for regular were 41.20 and 46.40, respectively.

Mr. Steve Shelton, the Executive Director of the Southern California Service Station Association, complained that Gulf Oil Company's policies were causing serious problems in Southern California. Mr. Shelton asserted that Gulf, operating through company owned and operated stations bearing the secondary brand names of Economy and Go-Lo, are posting retail prices as low as 48.9, which was 2 cents a gallon below the dealer's tankwagon price. Mr. Shelton said:

> Our primary problem in Southern California is the same as you probably heard all over the country. It is our inability to buy gasoline at a competitive price. Our dealers are forced to pay from 5 to 8 cents a gallon more for the product than the rack price or the wholesale value of the product. This historically has been made up in the past at least through August 1972 by the presence of price supports. Since the oil companies have discontinued this normal business practice, our dealers are suffering badly. Failures and closures are accelerating. The new trick seems to be for the oil companies to coerce, persuade or however get their branded lessee dealers to engage in below cost selling.* * * We have cases where Shell and Arco are both pressuring or coercing dealers to set retail prices that are injurious to the dealers and result in injury to other dealers.

Refiners assert that the delivery of gasoline to the stations they directly operate is not a sale, but merely a transfer, and thus they contend that they do not maintain records on such transactions. As a result, it is impossible to determine the wholesale price of gasoline delivered to company operated stations. Consequently, whatever profits or losses which result from their retailing activities are buried in an integrated accounting structure. Nontheless, it cannot be ignored that marketing has traditionally been the least profitable sector of the petroleum industry, and a refiner has already realized a profit on its product by the time it reaches the retail level. Thus, refiners have the financial ability to forego retail profits and this may account for the low retail price of gasoline at company operated stations.

Jobbers who operate retail stations avoid certain costs and many branded dealers contend that they should either have the ability to purchase gasoline at the rack price or that jobbers who compete at the retail level should be required to pay the dealer tankwagon price. The dealers assert that the differing prices are discriminatory and consequently all retail competitors should be treated equally and afforded the opportunity to obtain gasoline in whatever manner they determine to be best suited to their needs, and that all purchasers of gasoline be treated equally.

While the concept of rack pricing may eliminate price discrimination, refiners who are directly involved in retail marketing would still enjoy certain advantages. Obviously, refiners realize a profit on all gasoline sold through branded stations, although that profit may not come from the retail level. Nonetheless, the refiner has a financial interest in the station, and, to the extent that a refiner realizes a profit from the lessee, that lessee is contributing to the economic success of his retail competitor. Furthermore, since the refiner exerts certain controls over its competing lessee, it can affect that lessee's ability to compete.

Aside from the wholesale price of gasoline, one of the dealer's greatest expenses is his rent, which is determined by his landlord, who is also his supplier and his competitor. Thus, by adjusting the rent, a refiner can significantly affect a lessee dealer's ability to offer competitive prices. Since the court ruled that the Federal Energy Administration lacked the authority to control rents, many dealers have experienced substantial rent increases. Mr. Ken Nyland, a Getty dealer in Worcester, Massachusetts, had his rent increased from $350 a month to $850 a month. According to Mr. John Pankau, in Chicago, Shell increased rents from 2¼ cents a gallon to 3¾ cents a gallon, raising his rent from about $1,100 a month to about $2,300 a month. In California, Mr. Stan Tauber had the rent on his Gulf station increased from $1,100 to $3,700 a month. These examples are representative of the experiences of many dealers.

Historically, rents have been related to volume, with an established minimum and maximum rent. Thus, the greater the volume the lower the per gallon cost for rent. Additionally, rent was collected on a per gallon basis. With rents doubling and tripling, dealers are having to increase their retail price, which makes them less competitive which then decreases their volume which increases the per unit costs, and thus further weakens the economic and competitive position of the dealer. As the gallonage decreases, dealers are put under increasing pressure to lower their price, which, if unsuccessful, further jeopardizes the dealer's business. Since the branded dealer's major competitor is increasingly becoming the company operated station, it is unlikely that his competitor will experience a similar rent increase, if it experiences any increase at all. As the refiner operated station has a fixed rent, if it has any at all, and as it is receiving gasoline at a lower price than the dealer, it is fruitless for the dealer to try to compete, yet the refiner continues to pressure the dealer to do so. As the dealer's market position deteriorates, he becomes more vulnerable to the pressures of his supplier, who can then use this advantage to either fix prices or further enhance the position of the company operated station.

The experience of Mr. William Grillo, a Long Island Gulf dealer, demonstrates how a branded dealer's situation can deteriorate in the face of cut-rate competition. In December of 1974, the Gulf representative informed Mr. Grillo that he would have to vacate his station because Gulf wanted to convert it to a company operation. After receiving some publicity, Gulf relented and offered Mr. Grillo another one-year lease. Since then, a new marketer entered the area and began to post cut rate prices. As a result, Mr. Grillo's volume decreased. Then, another Gulf station opened within a mile of Mr. Grillo's station. Just before it opened, the Gulf representative told him that the new station would be posting 55.9 cents and 57.9 cents a gallon, and suggested that Mr. Grillo post 56.9 and 57.9 and 60.9 on self-service, and 2 cents more for full service. Mr. Grillo decreased his price and his volume declined even more. Meanwhile, the new Gulf station is doing very well, and Mr. Grillo is, in his words, "taking a beating." At the time of the hearing, the company was urging him to extend his hours of operation.

Another problem confronting dealers is changing marketing practices. Branded dealers have traditionally relied on providing full service to their customers. Given the cost of providing this service, many dealers are dependent upon the profits from their repair business for their economic survival. Some refiners have begun to compete for this repair business by establishing car care centers which are able to provide a variety of services. Because the cost of repair equipment, such as wheel balancers, is expensive, individual dealers can only afford to purchase certain items and thus cannot offer the variety or volume of service available at their refiner's large centers. Additionally, by concentrating on performing certain repair services and extensively advertising the availability of these services, the refiner's center can increase its volume and achieve full utilization of its equipment, which enables it to reduce its price for that service. Because a service station operator cannot concentrate on providing certain services, but must constantly switch from air condition repairs to tune-ups to oil changes, the dealer does not achieve the full utilization of his equipment, which means that he must spread the cost of that equipment over a fewer number of times the equipment is in use, thereby increasing the per unit cost of each use.

Additionally, suppliers pressure dealers to purchase repair equipment through the company, rather than from an independent automotive parts wholesaler. This not only frequently deprives local businessmen of the opportunity to supply other local businesses, but also can increase the cost of the equipment to the individual dealer. Mr. Mervin Klein of the Automotive Wholesalers Association of New England told the story of Lappen Auto Supply, which had sold a Hoffman Wheel Balancer to a Gulf station for $3,500. After closing the deal, Lappen was informed by the dealer that he could not purchase the wheel balancer from them because the dealer's ". . . TBA quota had been set so high that he had no reasonable chance of reaching his quota, unless he purchased that piece of equipment from the Gulf TBA jobber, even if he had to pay a higher price." Ironically, the TBA jobber did not have the equipment available and bought it from Lappen and had it sent to the original purchaser. Nonetheless, it is clear that oil companies pressure dealers to obtain their repair needs from the company, which not only can increase the dealer's cost but which also harms independent local suppliers.

While some major oil companies have begun to market repair service, other marketing changes have affected dealers' gasoline sales. Aside from the increased marketing competition from refiner operated stations, one of the most significant changes has been the growth of self-service. In California, self-service reportedly accounts for 46% of all retail sales. In 1972, there were only 30 self-service stations in Massachusetts, and by 1975 this number had increased to 375, with 150 additional applications pending in the State Fire Marshall's Office. Some States have banned self-service for safety or fire reasons, but the growth continues and presently about 40% of all gasoline is dispensed in this manner. Self-service reduces the need for numerous attendants, thereby reducing overhead and operating costs, which is passed on in the form of lower prices. Indeed, in some areas of the country, the attendant has been totally eliminated, and replaced with gasoline pumps which dispense gasoline when a dollar is inserted into a slot, as a vending machine.

Non-branded marketers were the originators of self-service, and the concept was greatly expanded when many refiners converted the stations they directly operate to this marketing method. Operators of full service stations complain that these "gas 'n' go" stations, as they are called, have taken the word "service" out of retail marketing, and thus do not adequately serve the motoring public. As the Executive Director of the New York State Association of Service Stations, Inc., Mr. Mac Victor, stated:

How will this serve the consumers? These small, low-gallonage service stations are a necessary part of business for the consumer, so they can get quick emergency service. With gas and go operations, there is no service whatsoever. Sell them the gas and get them out. If there is a tire ready to blow out, nobody is there to anticipate it. If there is something under the hood that should be taken care of that could result in some trouble on the road, nobody is there to see it.

Gas 'n' go, as far as we are concerned, will not, in terms of safety, serve the best interests of the consuming public.

Although many full service stations have responded to gas 'n' go outlets and self-service stations by establishing self-service islands, they must still maintain full service islands and all that goes with them, and thus do not realize the savings that high volume-low service stations do.

The non-branded independent retail marketers have also experienced competitive problems. During the Arab Oil Embargo, these retailers experienced the greatest difficulty in obtaining gasoline. While most stations were able to almost continuously receive 100% or more of their 1972 quantities of gasoline, the non-branded dealer was, at times, able to obtain less than 85% of his base period quantities. As a result, many non-branded stations were forced to close, and it has taken a considerable amount of time for them to regain their market position. Although precise figures are not available, it is generally conceded among those in the industry that non-branded marketers had about 10% of the market share prior to the embargo and had fallen to 7.4% in October 1974. It is estimated that the 1973 market share was even lower, but because FEA has refused to compile these figures, there are no reliable estimates available. By March 1972, the non-branded retailers had increased their share to 11.2%.

The independent non-branded retail marketers have traditionally capitalized on innovative and efficient marketing techniques and low wholesale gasoline prices. Refiner owned and operated stations have imitated these marketing techniques by concentrating on high volume-low overhead outlets and, as a result, have greatly decreased the price advantage non-branded marketers historically had. In February 1976, the weighted average price over all grades of gasoline and types of service stations for outlets operated by major integrated oil companies was 53.8 cents a gallon, while the same price for non-branded marketers was 53.5 cents a gallon.

More importantly, non-branded marketers are experiencing increasing difficulty in obtaining gasoline at competitive prices. Mr. Jim Lawrence, the Assistant General Manager of Thrift Oil Company, testified that at the time of the hearing, the Arco dealer tankwagon price was 34.4 cents a gallon and the rack price was 34.2 cents a gallon. The Hudson Oil Company representative stated that his company on the average was being required to pay one cent more a gallon than the major oil companies' dealer tankwagon price. Moreover, Mr. Lawrence also testified that some major oil companies are refusing to sign supply contracts with non-branded dealers while they are signing long term contracts with branded jobbers. Additionally, the major integrated oil companies have consistently refused to directly supply non-branded retailers with any significant quantities of gasoline and presently supply them with only 2% of their needs. Because of their concerted refusal, non-branded marketers are being forced to obtain an increasing amount of their gasoline from brokers, who add their costs and profits to the price, or from foreign sources, whose prices are higher because they refine the higher priced foreign crude.

As a result of higher wholesale costs and increased competition from low priced refiner operated stations, the competitive position and financial existence of the non-branded marketer is being jeopardized. Mr. Bob Stallings, the Marketing Vice President of Hudson Oil Company, which is the largest independent marketer in the country, supplied the Subcommittee with his company's average operating margin for its California stations, which shows a decline from 6.3 cents a gallon on January 3, 1975, to 2.6 cents a gallon on April 9, 1976. As Mr. Stallings said, "It does not take a soothsayer to readily see that Hudson's position as a viable independent marketer on the West Coast is in extreme jeopardy." Mr. Lawrence of Thrifty Oil Company stated that, "Our margins have shrunk to an unprofitable level. In short, Mr. Chairman, we can no longer afford to stay in business."

To remedy this situation, the Executive Director and General Counsel of the Independent Marketers Council, Mr. T. J. Oden, urged the creation of an equitable pricing system which would require that all refiners establish a base price for gasoline, so that all purchasers would be assured that they are paying a reasonable and fair price. Under this proposal, gasoline would be priced from the refinery forward and each refiner would be required to publicly disclose this base price on each major petroleum product. Price differentials would exist only to account for the functional differences performed by various classes of purchasers, and differences within the same class of purchasers must reflect the actual cost of providing additional services, such as credit card, transportation, brand identification, etc.

Mr. Oden also recommended the creation of an independent petroleum appeals board to assure the availability of adequate supplies at reasonable prices once Federal price and allocation controls end. This board would have the authority to deal with matters relating to price discrimination and refusals to deal on the part of refiners and suppliers. Finally, Mr. Oden urged the establishment of a moratorium on any future increases in the number of company owned and operated stations.

Many dealers complained about the ineffectiveness of the Federal Energy Administration. Mr. Stan Tauber, a California Gulf Dealer, stated that it took the FEA 2 years to resolve a dispute he had with his supplying refiner, whereby Gulf improperly altered their normal business practice in the system they used to charge for gasoline. Mr. Tauber testified that this change cost him over $10,000. Despite the fact this affected all Gulf dealers in California, the FEA imposed only a minor fine against Gulf while the dealers were not reimbursed for the losses they sustained as a result of this improper action.

A Long Island retailer complained that FEA regulations impeded her ability to open a new station for months, during which time two other stations opened without having to follow the procedures she did. A New York Exxon dealer filed a complaint and found that one reason it was being delayed was because FEA sent the complaint to Texaco. Mr. Charles Latorella, the New York State Assistant Attorney General of the Antitrust Division, complained that the FEA did not properly assist his office in prosecuting a law suit that related to their regulations and stated that he felt that ". . . the FEA should have done something about it," and that the problem would not have existed if the Agency had properly enforced its regulations. Mr. Mac Victor of the New York State Association of Service Stations, Inc., stated that ". . . we have seen areas where the major oil companies have ignored the regulations and have gotten away with it. We have complained about it. There have been investigations and so often it has been put off and time goes by and they can never always accomplish what they want with oil companies."

Mr. Maurice Langeller, the Executive Director of the Bay State Gasoline Retailers Association, complained that FEA's cooperation "hasn't been acceptable for the dealer." He went on to explain:

> The slow process of the FEA in ruling on any problems or complaints that are made. The process is unbelievable, the length of time involved. We have had complaints that have been sitting there since last October, and they've been assigned to investigators or assigned to auditing teams in the various sections of the country, wherever the refiners are located.
>
> And we're told it takes a long time for the auditing team to look into the situation, and that priorities exist. And obviously the dealer is not a priority, or the dealer is at the bottom of the totem pole.
>
> So, as far as success or any evidence of good cooperation on their part, no, it hasn't been evident.

The overall effectiveness of FEA can, in part, be judged by testimony of the Agency's Assistant Administrator for Regulatory Programs, Mr. Gorman C. Smith. Appearing before the House Small Business Subcommittee on SBA and SBIC Legislation, Mr. Smith disclosed that from January 1974 to December 1975 FEA received approximately 675 complaints relating to the termination of dealer leases. The Agency decided that it had no jurisdiction over 175 of these cases, and, of the remaining 500, 195 were resolved in favor of the dealer and 305 were resolved in favor of the oil company. As a result of these cases, the Agency took some kind of formal enforcement action against an oil company in 70 instances. Since 1972, over 42,000 dealers went out of business, and the market share of branded dealers has fallen from 79.3 percent to 71.5 percent.

Chapter IV.—Findings

The Subcommittee finds that the continued economic and competitive viability of both the independent branded and non-branded retail petroleum marketer is being jeopardized by the forward integration of refiners into the retail marketing sector of the petroleum industry. The Subcommittee believes that if this trend is allowed to continue, the small independent marketer will cease to be a competitive force and will continue to experience a decline in both numbers and market shares, which will not only be harmful to the interest of small business, but will also be detrimental to the best interests of the American consumer who will be harmed by the increased economic concentration in the petroleum industry which will result from this forward integration by refiners.

The Subcommittee believes that refiners are accomplishing this forward integration into the retail marketing sector of the petroleum industry by unfairly employing their superior economic resources to undercut the independent marketers' retail price of gasoline and thereby forcing them into either a non-competitive retail price or a competitive market price which will be financially ruinous for the individual dealer to maintain.

Furthermore, the Subcommittee finds that individual dealers lack the economic power to effectively negotiate equitable lease terms and, as a result, refiners have forced them to enter into agreements which deny them the authority to make important business decisions and thereby impedes their ability to perform as truly independent competitors.

It is the opinion of the Subcommittee that refiners have purposefully perpetuated the use of an unreasonably short term lease, even for experienced dealers, in order to emphasize to the dealer the tenuousness of his business relationship with his refiner. The common use of the one-year lease enables refiners to terminate their agreements with lessee dealers by simply failing to renew the lease. In the absence of any State law to the contrary, refiners are not required to establish any cause for their failure to renew a lease, and thus a branded lessee dealer is totally unprotected from the arbitrary actions of his supplier. Lacking the security of a long-term agreement and defenseless against the arbitrary actions of the supplying refiner, the lessee dealer is deprived of any effective means by which he can resist the pressures exerted against him by his supplier.

The Subcommittee finds that refiners have unfairly and improperly taken advantage of the lessee dealers' tenuous economic position to coerce them into unreasonable agreements which only serve the interest of the refiner and which frequently harm the interests of the small businessman and women. The most blatant example of this activity is the continuing pressure placed upon dealers to purchase the refiner's tires, batteries and automotive accessories. Service station dealers in all parts of the country complained that they are repeatedly being threatened by company salesmen that their leases will not be renewed if they purchase their TBA's from independent sources, and that they have no means by which they can effectively resist these pressures. Since most dealers assert that they can obtain superior products at lower prices through local suppliers, their inability to do so not only affects their competitive position but also harms the economic interests of the local small business supplier who is being deprived of the opportunity to competitively obtain a significant volume of business.

Refiners have also used their superior bargaining position to insert inequitable provisions into the lease as by specifying the hours a station shall be required to be open during periods of time when it is unprofitable to do so. This is particularly true for late night hours, when the available volume of business does not compensate the dealer for the increased costs of hiring additional attendants, or paying for higher utility bills, and insurance premiums. Many refiners have recently changed certain lease provisions and now the dealer is responsible for maintaining and repairing the refiner's property. Many dealers must now, at their own expense, repair and maintain the pumps, the lights, the repair equipment, heaters, plumbing and other equipment and even paint the station. This is not only costly in monetary terms, but also consumes a great amount of the dealer's time which could be devoted to profit-making activities.

The Subcommittee questions the economic justification for the recent rent increases which are being imposed upon dealers. Many dealers have complained that their landlord refiners have recently greatly increased these rents, which in some cases amount to 500 percent increases. Some dealers have asserted that these increases are unjustified and further inhibit their ability to effectively compete and are actually being used to coerce dealers out of business or make it unprofitable for them to continue to operate.

The forward integration of refiners into the retail marketing sector of the petroleum industry raises serious public policy questions. The refiners assert that, by directly marketing their own gasoline through high volume stations, they can eliminate the middle man and decrease their overhead costs and pass these savings along to the consumer in the form of lower retail prices. The dealers argue that, by concentrating on gasoline sales alone, these refiner operated stations fail to provide the consumer with the regular service needed to properly maintain the car, and that the low prices are an attempt to eliminate the competition and will disappear once a monopoly is established. At that time, the dealers assert, the refiners will unilaterally dictate the retail price of gasoline to the consumer as they now dictate the wholesale price to the dealer.

There is some evidence to support the contention that once a refiner obtains a significant share of the market he becomes less price competitive. In New Orleans, Exxon has opened a number of company operated stations and has gained a sizable share of the retail sales. According to the testimony of Mr. DuVal Dickey, Vice President of Marketing for Exxon Company U.S.A., before the Small Business Subcommittee on SBA and SBIC Legislation, Exxon ". . . sets the retail price" at company operated stations "at the level of the prevailing price of retail stations in the marketplace surrounding that individual station so there are no circumstances . . . where we would ever price a company station below the level of the prevailing price in the market." Mr. Dickey further stated Exxon does ". . . not consider that private brand, like Hess, like Save-Way, as the competition that we look to in the marketplace . . ." but instead looks at Texaco, Gulf, Shell, etc.

The implication of this testimony is that, having gained its share of the market, Exxon now only meets the price of its competitors, which is not true competition, especially when there are "no circumstances" when Exxon would ever price a company station below the prevailing level. Thus, it is clear from this testimony that once having obtained a significant share of the market, the largest integrated oil company is not aggressively pursuing price competition through company operated stations and is interested in meeting the retail price of only its major integrated competitors. With the elimination of the independent and non-branded retail marketer, price competition can be expected to decrease, and the Exxon testimony establishes that in such case the company operated station does not provide the consumer with the lowest possible retail price, but instead the highest price that can be charged without being undercut by another major integrated company. Since the demand for gasoline is inelastic, integrated refiners have historically avoided retail price competition and thus the Subcommittee questions if the recent lower retail price serves the long term interests of the consumers.

The European activities of Exxon also support the dealers' argument that low prices are only temporary. In 1968, Exxon unilaterally lowered its retail price at all its outlets throughout Europe, in some places by as much as 20%. This unprecedented action was in response to price wars initiated by independent marketers in various parts of Europe which had resulted in their obtaining an increasing share of the retail market, reaching a high of almost 20% in West Germany. Exxon continued this policy for two years, until the position and existence of the independent marketer had been eliminated. Although losses resulting from this action totaled almost a billion dollars in revenues and profits, Exxon and the other integrated oil companies survived, and, at the conclusion of this effort, they all raised their retail price which is, in Europe, no longer seriously subject to price competition from independent marketers.

The Subcommittee finds that the increasing forward integration of refiners in American has already seriously weakened the competitive position of both the branded and the non-branded independent retail petroleum marketers. The statistics show that for the first two years during which the Federal Energy Administration maintained records, over 42,000 individual independent retail marketers were forced to permanently cease operations, decreasing from 235,859 in early 1972 to only 193,500 in late 1974. Since 1974, the market share of the independent branded dealer has continued to dramatically decrease, going from 79.3 percent in October 1974 to 71.5 percent in March 1976. It is more than mere circumstance that the forward integration of refiners has resulted in a substantial increase in the market share of company operated stations during this same period, going from only 8% in 1972 to 17.2% by March 1976.

The Subcommittee believes that the large integrated refiners have engaged in a concerted effort to deny independent non-branded retail marketers access to gasoline at competitive prices. Presently, integrated oil companies refuse to sell any substantial quantities of gasoline directly to these retailers, and provide the larger independent marketers with less than 2% of their needs, although they supply substantial quantities of excess gasoline to smaller refiners who, in turn, resell it to independent marketers at a higher price. Additionally, many integrated refiners are refusing to sign long term supply contracts with independents. These policies have unnecessarily increased the wholesale price of gasoline and have thereby undermined their ability to compete at the retail level. Furthermore, the inability to obtain supply contracts is increasingly forcing independent marketers to rely on the higher priced foreign gasoline which is further impeding their ability to compete.

It is the opinion of the Subcommittee that the existing wholesale price structure for refined petroleum products lacks an economic foundation and is being manipulated to serve the competitive interests of refiners. It is inconceivable that the wholesale price of delivered gasoline can be lower than the wholesale price of undelivered gasoline from the same refiner. Nor is it economically possible for refiners to profitably post a retail price at company operated outlets which is almost the same as their wholesale price to dealers.

The disparity in wholesale prices is reflected by the fact that, in February of 1976, the weighted average retail price over all grades of gasoline and types of service stations for major refiner operated outlets was only 53.8 cents a gallon, while the same price for their branded dealers was 58.5 cents a gallon. By providing discounts or allowances to certain purchasers within a particular category and lacking any requirement that price reflect cost, refiners have unilaterally dictated varying wholesale prices to differing categories of purchasers. By so doing, refiners have successfully established arbitrary wholesale prices which discriminate against certain classes of purchasers and which have enabled them to effectively manipulate the retail price of gasoline for their own competitive advantage.

The Subcommittee finds that the preservation of both the branded and the non-branded independent retail marketer is essential to the maintenance of competition in the retail sector of the petroleum industry. The Subcommittee believes that the independent marketer cannot successfully endure the pressures created by the forward integration of refiners into the marketing sectors as long as those refiners are able: to impose unprofitable terms in their leases with dealers; to coerce dealers into purchasing large quantities of TBA's at excessive prices from their supplying refiners; to intimidate dealers through short term leases and business relations which afford no protection from arbitrary action by the refiner; to require dealers to purchase their gasoline at a non-competitive price which is unilaterally dictated by the refiner; to unfairly compete at the retail level with a dealer while maintaining absolute control over many of the dealer's costs and marketing practices; to manipulate the wholesale pricing system to the competitive advantage of their company operated stations; and to use the profits in the other endeavors to underwrite the financial cost of petroleum retailing. Subjected to these pressures, independent marketers cannot resist the concerted efforts of their supplying refiner.

The 1956 Report of the Attorney General's National Committee to Study Antitrust Laws states that "Effective competition may be affected not only by the number of sellers; their relative size and strength must also be considered. This does not mean that close equality in size among various firms is essential for workable competition to exist, but only that the rivalry should not depend entirely upon sellers who are so weak or inefficient as to exist by sufferance." Given the success refiners have achieved with their forward integration efforts, their ability to control supply and the price of that supply and the power to require dealers to comply with their demands, and mindful of the experience of European marketers, the Subcommittee concludes that independent dealers do not have the strength to effectively compete against refiners and their existence is therefore at the sufferance of their supplying refiner. The Subcommittee believes that the dealers' weakened position is the result of their unequal bargaining power which places them under serious competitive handicaps which are irrelevant to their efficiency. Thus, the Subcommittee reiterates the finding of the United States Supreme Court which, in *Atlantic Richfield Company* v. *FTC*, 381 U.S. 357, 85 S. Ct. 1498, ruled that "Substantial evidence supports the conclusion that notwithstanding Atlantic's contention that it and its dealers are mutually dependent upon each other, they simply do not bargain as equals. Among the sources of leverage in Atlantic's hands are its lease provisions and equipment loan contracts with their cancellation and short term provisions."

Previous hearings held by the House Select Committee on Small Business have noted the unequal bargaining position of small, independent retail marketers. In a 1955 report entitled "Alleged Coercive and Discriminatory Practices against Retail Gasoline Operators by Oil Companies," the Select Committee found that "the dealer operating his station under a short-term lease with the oil company supplier is frequently not in fact independent and is subject to control by the oil company supplier. The freedom of choice of the dealer with respect to the manner in which he operates his station is circumscribed by the economic power of his oil company supplier, whether or not such power is specifically exercised against him." The Subcommittee recommended that the industry adopt long-term leases, but after 20 years, short-term leases remain the most common. The Committee also found that the refiners' sales practices in regard to sponsored TBA's ". . . have had the effect of operating against a dealer's freedom of choice in using or dealing in competitive products, and operate to substantially lessen competition and tend to eliminate price competition."

In 1957, the Select Committee again considered the problem of the small business petroleum retailer and found that "the extent to which small business distributors and retailers of petroleum products are truly free and independent is severly limited by their awareness that their suppliers can wield great economic power." The Committee also concluded that "Price discrimination and coercion still exist in the industry." To remedy these problems, the Chairman of the Subcommittee which conducted the investigation, the Honorable James Roosevelt (D-Calif.), introduced legislation which would divorce producers of petroleum products who sell at wholesale from selling at retail.

Most European governments have adopted policies which separate the refiner from the retailing activities or which impose severe limitations on the number of stations a refiner may own. Additionally, many of these European governments have nationalized parts of the petroleum industry and now directly compete with large integrated refiners.

These actions have not impeded the economic viability of these integrated corporations or in any way weakened their ability to effectively function on an international scale. Indeed, since the imposition of these European restrictions, these companies have experienced their most profitable years.

The Subcommittee is of the opinion that immediate Federal action is needed to preserve the independent retail marketer from the coercive and inequitable competitive practices utilized by refiners who are using their superior bargaining position to increase the market share of company owned and operated stations. The need for Federal action is clear from the fact that dealers in all parts of the country are experiencing the problem which is being caused by a variety of refiners. The action must be immediate because over 42,000 dealers have already been forced out of business and because within the last 18 months for which figures are available, the independent branded dealers have experienced a significant decline in their market share, going from 79.3% in October of 1974 to 71.5% in March 1976.

Although the FTC has initiated a court action which would require the major oil companies to divest themselves of certain operations, a decision will not be reached until at least 1980, and it is estimated that, if this trend is not stopped, at least another 40,000 dealers will have gone out of business. Additionally, the courts have repeatedly acted to curtail the activities of the major oil companies, but those actions have failed to prevent the problems which exist today. Therefore, the Subcommittee believes that it is time for Congress to directly exercise the power it delegated to the courts under the Sherman Act and the Clayton Act and legislatively impose restrictions on the scope and methods of the activities of the integrated oil companies by preventing them from directly engaging in the retail marketing of petroleum products.

The Subcommittee further believes that the Federal Government should enact legislation which prohibits suppliers from arbitrarily terminating their dealers. Terminations or non-renewals of leases should be conditioned upon the showing of "good cause" and all lease provisions should be subject to a rule of reasonableness with the right of judicial review. To avoid the possibility of protracted and expensive legal costs, suppliers should be required to bear all the expenses of court action so that they cannot unfairly use their superior economic power to deprive a small businessman of his day in court, unless the court rules that the suit was maintained solely to harass the supplier. The Subcommittee realizes that protecting the dealers from the arbitrary actions of their refiners does not adequately protect them from coercive economic pressures which the supplier can exert through direct retail competition from company operated stations and thus concludes that refining activities must be totally separated from retailing activities, although refiners should not be required to sell their stations. Additionally, the Subcommittee believes that the Federal Government must act to prevent refiners from manipulating the wholesale price of gasoline and that an equitable pricing system must be established that is built upon a base cost at the refinery which is offered to all legitimate wholesalers and retailers, and that the price of any additional service which the buyer elects to have the refiner perform reflect the actual cost of providing that service. Furthermore, the Subcommittee finds that the Federal Government must anticipate the end of allocation and price controls and establish an independent petroleum appeals board to insure that all marketers receive adequate supplies at fair and equitable prices.

Finally, the Subcommittee finds that the Federal Energy Administration has failed to effectively protect individual dealers from the coercive practices of refiners. Specifically, the Subcommittee notes that the FEA has failed to enforce the provisions of the Emergency Petroleum Allocation Act of 1973 which instruct the agency to protect and maintain the non-branded independent retailers' market share. This can be seen from the fact that the FEA has failed to accumulate statistics to determine what the non-branded marketers' share was prior to the disruptions caused by the Arab embargo. Additionally, the Subcommittee believes that the agency has failed to adequately protect or efficiently process the complaints of individual dealers and that it has made an insufficient effort to determine and prevent a repetition of the causes which have resulted in the substantial declines in the number of independent small business retailers. The Subcommittee finds it inconceivable that the agency has taken only 70 formal enforcement actions in light of the fact that over 42,000 dealers have gone out of business and that the market share for branded dealers has fallen from 79.3% to 71.5%.

Chapter V.—Recommendations

On the basis of the testimony, evidence and findings, the Subcommittee recommends:

A. That the Federal Energy Administration:

(1) Restructure its enforcement division to insure that dealer complaints are responded to within 10 days of receipt and that they are thereafter efficiently processed;

(2) Review its regulations to determine where they fail to adequately protect the interests of dealers, and make such revisions as needed;

(3) Aggressively pursue remedial action against suppliers that results in equitable solutions for dealers and which fully compensates them for any losses they suffered as a result of any refiner's violation of the regulations;

(4) Make a concerted effort to locate dealers who have been forced out of business to determine if any refiner's violation of FEA's regulations was responsible for the discontinuation of their business;

(5) Evaluate the economic justification for recent rent increases to determine if they are attempts to circumvent price controls; and

(6) Report to this Subcommittee by April 1, 1977, of the actions taken to implement these recommendations.

B. That the Federal Trade Commission:

(1) Investigate the sale techniques of supplying refiners to determine if they are using illegal or coercive practices to require dealers to purchase refiner supplied tires, batteries and accessories;

(2) Promulgate a trade regulation which would establish a functional pricing system within the wholesaling segment of the petroleum industry;

(3) Investigate the wholesaling practices of the major integrated refiners to determine if they are engaged in a concerted effort to refuse to sell to independent non-branded retail marketers; and

(4) Report to this Subcommittee by April 1, 1977, of the actions taken to implement these recommendations.

C. That the appropriate committees of Congress favorably consider legislation which would:

(1) Prevent refiners and suppliers from arbitrarily terminating or failing to renew a dealer's lease or supply contract by requiring that such action be dependent upon a judicially reviewable showing of good cause;

(2) Prohibit refiners from engaging in the wholesale distribution of tires, batteries or any other automotive accessories which are not a refined petroleum product;

(3) Prevent refiners from directly competing with the small business retailers they supply by prohibiting them from directly

operating retail gasoline outlets or engaging in the direct retail marketing of gasoline;

(4) Require refiners to establish a functional pricing system for determining the wholesale price of gasoline, and that all buyers within the same category of purchasers be allowed to purchase gasoline at a base price, and that charges for any additional services be the same for all buyers and reflect the actual cost of providing that service; and

(5) Establish an independent petroleum appeals board which would have the authority to insure that all marketers receive an adequate supply of gasoline at a fair and equitable price once Federal price and allocation controls end.

ADDITIONAL VIEWS OF HON. MILLICENT FENWICK

I was not present at any meetings of this Subcommittee and I do not feel I can judge the report or join in its conclusions.

MILLICENT FENWICK, M.C.

ADDITIONAL VIEWS OF HON. JOHN Y. McCOLLISTER

The large integrated oil companies have the ability to put a tremendous amount of pressure on their small retail marketers. Although I am not a member of the Subcommittee on Energy and Environment, I have fully supported the Subcommittee in its efforts to determine the nature and extent of marketplace abuses.

This report was prepared in the final days of the 94th Congress, however, and I have not had an adequate opportunity to study the hearing record or examine the possible implications of the conclusions and recommendations of this report.

I, therefore, wish to disassociate myself from the recommendations contained herein until I have had the opportunity to fully acquaint myself with the Subcommittee's findings.

JOHN Y. McCOLLISTER, M.C.

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